No. 10061

IN THE

UNITED STATES CIRCUIT COURT OF APPEALS

For the Ninth Circuit

UNITED STATES OF AMERICA,

Appellant,

vs.

THE COAST WINERIES, INC., a corporation, and UNITED STATES FIDELITY AND GUARANTY COMPANY, a corporation,

Appellee.

UPON APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE WESTERN DISTRICT OF WASHINGTON, NORTHERN DIVISION

Brief of Appellee

ALLEN, HILEN, FROUDE & DeGARMO,
Gerald DeGarmo,
1308 Northern Life Tower,
Seattle, Washington.

HUBBERT & MULLINS,
W. A. Hubbert,
402 Miller Building,
Yakima, Washington.

H. W. B. SMITH,
444 California Street,
San Francisco, California.

Attorneys for Appellee,
United States Fidelity and Guaranty Company.

FRAYN PRINTING COMPANY

No. 10061

IN THE

UNITED STATES CIRCUIT COURT OF APPEALS

For the Ninth Circuit

UNITED STATES OF AMERICA,

Appellant,

vs.

THE COAST WINERIES, INC., a corporation, and UNITED STATES FIDELITY AND GUARANTY COMPANY, a corporation,

Appellee.

UPON APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE WESTERN DISTRICT OF WASHINGTON, NORTHERN DIVISION

Brief of Appellee

ALLEN, HILEN, FROUDE & DeGARMO,
Gerald DeGarmo,
1308 Northern Life Tower,
Seattle, Washington.

HUBBERT & MULLINS,
W. A. Hubbert,
402 Miller Building,
Yakima, Washington.

H. W. B. SMITH,
444 California Street,
San Francisco, California.

Attorneys for Appellee,
United States Fidelity and Guaranty Company.

FRAYN PRINTING COMPANY

SUBJECT INDEX

TABLE OF CASES

TABLE OF CASES (Continued)

TEXTBOOKS

CODES

No. 10061

IN THE

UNITED STATES CIRCUIT COURT OF APPEALS

For the Ninth Circuit

UNITED STATES OF AMERICA,

Appellant,

vs.

THE COAST WINERIES, INC., a corporation, and UNITED STATES FIDELITY AND GUARANTY COMPANY, a corporation,

Appellee.

UPON APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE WESTERN DISTRICT OF WASHINGTON, NORTHERN DIVISION

Brief of Appellee

PREFACE

The Judgment of the trial court from which this appeal was taken is based upon the following Conclusions of Law: (R. 70)

"I.

"That the proceedings in the Matter of the Bankruptcy of The Coast Wineries, Inc., in Cause Number B-1959, in the District Court of the United States for the Eastern District of Washington, Southern Division, and in particular the Order of Judge J. Stanley Webster of November 12, 1937, are *res judicata* between plaintiff and defendant, United States Fidelity

and Guaranty Company, upon the issues presented by this suit, and the action of the plaintiff to recover from the defendant, United States Fidelity and Guaranty Company, upon the tax claim asserted herein, is barred by the former adjudication, expunging and disallowing said claim.

"II.

"That the plaintiff is estopped to assert the claim sued upon herein as against the defendant, United States Fidelity and Guaranty Compay."

Appellant does not contend that the Findings of Fact do not support these Conclusions, but rather argues that the Findings of the trial court, upon which the Conclusions are based, are not supported by the evidence or the law.

Under the circumstances, we think it is important that this Court be furnished with a complete and comprehensive statement of the facts as shown by the record. The Statement of Facts as contained in appellant's brief is largely a recitation of the pleadings rather than of the facts, and is so fragmentary and incomplete that we have found it impossible to supplement it without resulting confusion. Much of the evidence is not found in the Transcript of Record but rather in the exhibits, the originals of which have been brought before this Court, and we are, therefore, taking the liberty of setting forth a complete statement of facts as supported by the evidence introduced at the trial and found by the trial court to be correct.

STATEMENT OF FACTS

On February 1, 1934, The Coast Wineries, Inc., a Washington corporation, executed and delivered a "Producer's" bond to the United States of America, in the sum of $5,000.00, with the appellee, United States Fidelity and Guaranty Company as surety. (R. 5-6) On August 9, 1934, a similar bond was executed and delivered for $3,000.00, with the same surety. (R. 7-8) As a condition to the writing of these bonds, the appellee required indemnitors in the persons of J. J. Dolph, W. A. Hubbert and Maude Hubbert, his wife, C. T. McKenzie and Bertha McKenzie, his wife. (R. 129)

In February of 1935, The Coast Wineries, Inc., filed a Petition in the United States District Court for the Eastern District of Washington, Southern Division, for reorganization under Section 77B of the National Bankruptcy Act. On February 27, 1935 appellant, through Alex. McK. Vierhus, Collector of Internal Revenue for the Collection District of Washington, filed a Creditor's Claim (Defendant's Exhibit A-2) for $501.67, as "Capital Stock Tax Assessed under Sec. 215 of the National Industrial Recovery Act." On March 4, 1935, a second claim was filed by and through Alex. McK. Vierhus, Collector, for $9,387.21, stated as being "Tax on Distilled Spirits Assessed under Sections 3244 and 3176 of Revised Statutes and under Liquor Taxing Act of 1934" (Defendant's Exhibit A-1). On June 10,

1935, a third claim was filed for $76.20, as "Proposed Assessment of Documentary Stamp Tax under Title V, Part III, Revenue Act of 1932" (Defendant's Exhibit A-3). A portion of the tax, as claimed and covered by the claim (Defendant's Exhibit A-1 for $9,387.21, was that assessed as follows: 605 RA 10,541 P. G. Mixed Wine (Rectified) Rate $.30 $3,162.56 (Plaintiff's Exhibit 1). This item of tax was that upon which this action was commenced.

On June 6, 1935, the Acting District Supervisor of the Alcohol Tax Unit of the Treasury Department, Internal Revenue Service at Seattle, Washington, sent a notice to appellee of the filing of the reorganization proceedings by The Coast Wineries, Inc., advising that the Government had filed its claim for taxes in the sum of $9,387.21, and ended the letter stating: (Plaintiff's Exhibit 2)—

> "Notice is hereby given of your liability to the extent of your bonds for any such taxes not collected from the bankrupt estate, in order that you may take any action you may deem necessary."

Acting upon this notice the appellee promptly gave notice of possible liability to its indemnitors (Plaintiff's Exhibits 6, 7).

On June 16, 1935, The Coast Wineries, Inc., was adjudicated bankrupt. (R. 114)

Following the adjudication of The Coast Wineries, Inc., as a bankrupt, the Yakima Valley Bank

and Trust Company was appointed as Trustee, and was authorized to employ Messrs. W. B. Clark and T. E. Grady, Attorneys of Yakima, Washington, as its attorneys. (R. 92, 93)

The only substantial asset of The Coast Wineries, Inc., at the time of its adjudication in bankruptcy, was a quantity of wine, the production and rectification of which formed the basis of the Government's claim for $9,387.21 in taxes, as covered by its Creditor's Claim (Defendant's Exhibit A-1). This wine, in the hands of the Trustee in Bankruptcy, was ordered sold, and resulted in a sale for $12,000.00 to one R. D. Rovig. (R. 116) On September 16, 1935, an Order was entered by Judge J. Stanley Webster (Plaintiff's Exhibit 5), ruling that the wine should be delivered to Mr. Rovig, free and clear of all taxes, and directing the Trustee in Bankruptcy to purchase and affix to the containers the Internal Revenue Stamps covering the gallonage and withdrawal taxes. This Order further provided:

> "IT IS FURTHER ORDERED, ADJUDGED AND DECREED that any and all claims which the United States Government has, or may hereafter have or assert, if any, against the proceeds from the sale of said property in the the hands of the Trustee, and the validity, amount and priority thereof shall hereafter be determined by the Court."

Pursuant to this Order there were purchased by the Trustee, from the $12,000.00 sale price of the wine,

Internal Revenue Stamps to the amount of $9,171.62. (R. 144)

While the matter of the sale of the wine, just mentioned, was proceeding in the bankruptcy action, the Trustee in Bankruptcy filed a "Statement of Objections To Claim of United States Government" (Defendant's Exhibit A-4), in which objections were made to all three claims of the Government (Defendant's Exhibits A-1, A-2, A-3). These objections stated valid grounds for denial of tax liability on the part of the bankrupt as to all three claims. To these objections the United States of America filed a "Motion of United States of America, Claimant" (Defendant's Exhibit A-5).

On September 3, 1935, a Special Master was appointed by Judge Webster, to hear and pass upon numerous matters in connection with the bankruptcy of The Coast Wineries, Inc. On September 6, 1935, the Special Master sent out a "Notice of Hearing Before Master To The Creditors of The Coast Wineries, Inc." (Defendant's Exhibit A-6), notifying of a hearing to be held on September 18, 1935, at nine-thirty o'clock, A. M. Among other items, this Notice stated that the hearing was to determine:

> "The amount, validity and priority of the claims of the United States, the State of Washington and Yakima County for taxes and assessments."

On the morning of September 18, 1935, at Yakima, Washington, and prior to the hearing before

the Special Master, a meeting occurred between Judge Thomas E. Grady, attorney for the Trustee in Bankruptcy of The Coast Wineries, Inc., and Mr. Thomas R. Winter, Special Attorney for the Bureau of Internal Revenue, at which it was agreed, as found by the trial court, that if the Trustee would withdraw his objections to the claims of appellant for $501.67 and $76.20, respectively (Defendant's Exhibits A-2 and A-3), the appellant would withdraw, as abated, its larger claim for $9,387.21. (Defendant's Exhibit A-1) (R. 100-101). In accordance with this agreement between counsel, Judge Grady, as attorney for the Trustee, and Mr. Winter, as Special Attorney for the Bureau of Internal Revenue, appeared before the Special Master on September 18, 1935, and made the following statements, as appears from the record: (Plaintiff's Exhibit 9)

> "MR. WINTERS: If the Court please, I represent the United States Government. I do not know whether it has been explained to your Honor or not, but Saturday Judge Webster entered an order directing the Trustee to purchase stamps and put on the wine which has not been sold, and directed the Government to gauge that wine and figure out the alcoholic action, and that is being done this afternoon.
>
> The Government has a claim for some $9,043.00—anyway, over nine thousand dollars. Three proofs of claim have been filed, first a claim for $9,000, which is the rectifying tax, the stamp tax, and special tax as rectifier's license and so forth, and penalties. I am informed, at least I have an understanding, that the Trustee is going to file a claim in abatement of all of

that tax in view of Judge Webster's decision, and if that claim in abatement is allowed, the Government will request authority to withdraw the $9,000 claim filed in this Court, and there will be no use taking testimony in that matter.

I filed a motion against Judge Grady's objections to the Government's claims, and my motion went to all three claims.

Now, will the Court continue the hearing on the Government $9,000 claim until some later date, in order that the claim in abatement might be filed, and in all probability the claim will be withdrawn if the claim in abatement is allowed?

THE MASTER: There is just a possibility of that?

MR. WINTERS: Well, it has developed into more than a possibility, as I have advised Judge Grady, and I have assurance from the Government, and I am personally recommending the abatement of the claim in view of the situation in this matter, but, so far as the two other claims—now, we have two separate claims that have been filed, one for $500.00, claim for capital stock tax assessed under Section 215 of the NRA, to which Judge Grady has filed what he calls a statement of objections, and I have excepted to the statement; and the other claim is a $76.00 stamp tax assessed under Title 5 of the Act of 1932.

THE MASTER: What is the amount of the capital stock tax?

MR. WINTERS: It is five hundred dollars and some odd cents, and the stamp tax on the issuance of stock is $76.00. These two claims involve purely a question of law, and if convenient to Judge Grady, I would be willing to submit it on a short memorandum of authorities.

MR. GRADY: That is all right with me.

THE MASTER: That is satisfactory with me.

MR. WINTERS: There is no question of fact involved.

MR. GRADY: No, the amount is all right, except perhaps if there are any penalties attached to it. I don't think there are in these two claims.

* * *

THE MASTER: The matter of the claim of the United States for rectifying tax is continued to the 28th day of September, 1935."

On September 28, 1935, pursuant to the continuance granted on September 18, 1935, the matter again came on for hearing before the Special Master. Mr. Winter again appeared, and the following occurred: (Plaintiff's Exhibit 10)

"MR. WINTERS: With respect to the claim of the United States for nine thousand and some odd dollars the Trustee has duly filed a claim in abatement with the Collector of Internal Revenue seeking the abatement of the full amount covered by this claim, and in view of the order of the Court authorizing and directing the Trustee to purchase and cancel stamps on the wine sold to R. D. Rovig, I am recommending to the Commissioner of Internal Revenue that the tax covered by the aforementioned claim be abated, in which event the claim will be withdrawn.

It is, therefore, requested that an extension be granted of ten days in order to allow administrative action to be taken by the Bureau of Internal Revenue.

THE MASTER: Motion granted.

MR. GRADY: The trustee recommends to the

> Master that the $500.00 capital stock stamp tax claim, and the other $76.00 stock tax claim be allowed to take the priority under 64-A."

On October 15, 1935, the Collector of Internal Revenue, at Tacoma, Washington, sent a letter to the Clerk of the District Court for the Eastern District of Washington (Defendant's Exhibit A-7), stating in plain and unequivocal language the following:

> "Reference is made to our claim No. 2 filed under date of June 7, 1935 covering tax on distilled spirits due from the above named corporation in the amount of $9,387.21.
>
> You are advised that upon the recommendation of the District Supervisor of the Alcohol Tax Unit, we have abated the above tax and are withdrawing our proof of claim covering the same. Our claims No. 1 and No. 3 covering capital stock taxes are still in effect."

Pursuant to this letter, the Special Master filed his Report and Recommendations on December 6, 1935, and with reference to the claim of the Government for $9,387.21 (Defendant's Exhibit A-1), reported as follows: (Defendant's Exhibit A-8)

> "Claim No. Sixty-nine (69) filed by the United States Collector of Internal Revenue in the amount of Nine Thousand Three Hundred eighty-seven and 21/100 ($9,387.21) has been withdrawn (Trustee's Exhibit J). This claim represented a tax on distilled spirits assessed under Sections 3244 and 3176 of the Revised Statutes and under the Liquor Taxing Act of 1934. The tax was abated under date of October 15, 1935."

Slightly more than a year later, on December 21, 1936, Judge Webster filed a "Memorandum Opinion" (Defendant's Exhibit A-9), approving the report of the Special Master.

While the foregoing proceedings were being carried on in the Bankruptcy Court, word came to the appellee that the claim of the United States for taxes, as covered by the Creditor's Claim (Defendant's Exhibit A-1), and as to which defendant had been given notice of liability by the letter of June 6, 1935 (Plaintiff's Exhibit 2), had been abated and withdrawn. (R. 123, 124) In reliance upon this information, defendant abandoned its intention to file a Creditor's Claim against the Estate of its indemnitor, J. J. Dolph, which was then in probate in the Superior Court of the State of Washington for Spokane County, and permitted the time for filing Creditors' Claims against this estate to expire (Defendant's Exhibit A-13). (R. 125, 126) The certified copy of the Inventory and Appraisement of this Estate, filed herein as "Defendant's Exhibit A-12", disclosed ample assets from which such a Creditor's Claim could have been paid, if asserted. Believing that the claim against it upon its bonds had been closed, the defendant closed its claim files upon the claim. (R. 126)

Approximately one and one-half years after the Bankruptcy Court had been definitely advised, on

October 15, 1935, that the Government's claim for taxes, in the sum of $9,387.21, and as covered by its Creditor's Claim (Defendant's Exhibit A-1), had been abated and withdrawn, the Government, on April 15, 1937, filed *In the Matter of Coast Wineries, Inc. Bankrupt,* a new Creditor's Claim, (Defendant's Exhibit A-10), for $3,162.56, being a portion of the tax which the Court had previously been advised had been abated (Plaintiff's Exhibit 1). Upon oral objection of the Trustee to the allowance of the claim, the matter came on for hearing before Judge J. Stanley Webster on October 5, 1937. As a result of this hearing an Order was entered November 12, 1937 (Defendant's Exhibit A-11), which provided:

> "ORDERED, ADJUDGED AND DECREED that the said claim of the United States in the sum of $3,162.56 filed on April 13, 1937, be, and the same is hereby expunged and disallowed."

No appeal or petition for review of this Order was ever taken.

Again an interval of approximately one and one-half years elapsed, and on March 7, 1939, the United States of America made demand upon appellee for the $3,162.56 in taxes for which Judge Webster had denied recovery, and upon refusal of appellee to pay the amount demanded this action was instituted.

ARGUMENT

As pointed out in the preface to this brief, the Judgment in favor of appellee is based upon two grounds,— res judicata and estoppel. Either of

these grounds is self-sufficient, and although we believe both are amply supported by the record, the Judgment must be affirmed if either is found to be meritorious.

Appellant has seen fit in its brief to devote itself primarily to an attack upon the finding of estoppel, apparently in the hope of diverting attention from the conclusive effect of the finding of res judicata. We shall hereafter demonstrate the unsoundness of the attack upon the defense of estoppel, but wish first to present argument concerning the finding of res judicata.

Res Judicata

In the Matter of the Bankruptcy of The Coast Wineries, Inc., there were two separate and conclusive adjudications concerning the tax claim in issue, either of which were and are sufficient to constitute ample grounds for the defense of res judicata and to support the Judgment of the trial court. It is an admitted fact that the taxes, recovery of which are sought in this action, were included in the original claim filed by appellant in the bankruptcy proceeding. (Defendant's Exhibit A-1.) With respect to this claim, the Special Master reported on December 6, 1935 (Defendant's Exhibit A-8):

> "Claim No. Sixty-nine (69) filed by the United States Collector of Internal Revenue in the amount of Nine Thousand Three Hundred eighty-seven and 21/100 ($9,387.21) has been

> withdrawn (Trustee's Exhibit J.) This claim represented a tax on distilled spirits assessed under Sections 3244 and 3176 of the Revised Statutes and under the Liquor Taxing Act of 1934. The tax was abated under date of October 15, 1935."

This report and recommendation was approved by Judge J. Stanley Webster on December 21, 1936. (Defendant's Exhibit A-9.)

Subsequently, on April 15, 1937, appellant filed a new Creditor's Claim in the bankruptcy proceeding for the tax sought to be recovered by this action, to which claim oral objections were made by the Trustee. The claim and objections were heard before Judge J. Stanley Webster on October 5, 1937, and resulted in the entry on November 12, 1937, of an Order which provided: (Defendant's Exhibit A-11)

> "ORDERED, ADJUDGED AND DECREED that the said claim of the United States in the sum of $3,162.56 filed on April 13, 1937, be, and the same is hereby expunged and disallowed."

Neither the Order of December 21, 1936, nor that of November 12, 1937, were appealed from by appellant in this action.

Appellant has sought to escape the force of the latter Order of November 12, 1937, by arguing, first, that it had withdrawn its claim from consideration by the Court, and hence there was nothing before the Court upon which the Order could operate; and, second, that its claim was non-provable in character

and that this was the basis of the Judgment of the Court. (Appellant's brief, 23, 24.) THESE CONTENTIONS HAVE NO SUPPORT IN FACT. The Order of Judge Webster clearly showed that the claim had not been withdrawn, but was before the Court for adjudication upon its merits, and it was by the Order itself that the claim was "expunged and disallowed." No reason is stated in appellant's brief why its tax claim was a "non-provable" one under the Bankruptcy Act, and we submit that no sound reason can be advanced in support of this position.

The relationship of The Coast Wineries, Inc., and of appellee, United States Fidelity and Guaranty Company, to the United States of America was that of principal and surety, respectively. This relationship is definitely established by a study of the statutes under which the bonds were given and the obligations of the bonds themselves.

The bonds were written pursuant to the provisions of what is now 26 *U. S. C. A., Section* 3040 (formerly 26 *U. S. C. A., Section* 1306), reading as follows:

> *"Requirements on producers.*
>
> "(a) *Notice, bonds, and stamps.* Every person producing after February 24, 1919, or having in his possession or under his control on February 24, 1919, any wines subject to the tax imposed in paragraphs (1) and (2) of section 3030(a) shall file such notice, describing the

premises on which such wines are produced or stored; shall execute a bond in such form; shall make such inventories under oath; and shall, prior to sale or removal for consumption, affix to each cask, barrel, bottle, or other immediate container, and to each case or other shipping container, of such wine, such marks, labels, or stamps as the Commissioner, with the approval of the Secretary, may from time to time prescribe as to each; and the premises described in such notice shall, for the purpose of this chapter, be regarded as bonded premises."

The conditions of the bonds which were required of The Coast Wineries, Inc., pursuant to the provisions of the statute quoted, and which bonds form the basis of appellant's claim against the appellee were as follows:

"WHEREAS, the above bounden principal is engaged or intends to engage in business of making and selling domestic wines on premises located at 213 West P Street, in the Twelfth Collection District of Washington.

"NOW, THEREFORE, the condition of this obligation is such that if the said principal shall fully and faithfully comply with all requirements of the laws of the United States and regulations issued in pursuance thereof respecting the production, storage, sale or removal and the accounting of all wines produced or received by him, or which now remain on said premises; and if the said principal shall well and truly pay all taxes due on said wines at the time and in the manner required by said laws and regulations, then this obligation to be void; otherwise to remain in full force and effect."

A study of these conditions, coupled with reference to the statute under which the bonds were required,

clearly discloses that the obligation of appellee was ancillary to the liability of the principal, The Coast Wineries, Inc.

It is a fundamental rule of law of principal and surety that the surety is relieved by any defense which would be available to the principal.

50 Corpus Juris 71, Section 126.

50 Corpus Juris 74, Section 127.

21 R. C. L. 974, Section 27.

As a corollary to the rule just stated, it is an established rule of law that a surety can set up as a defense a judgment rendered in favor of its principal, and that a judgment which is res judicata, and a bar so as to release a principal from obligation, also releases his surety.

50 Corpus Juris 93, Section 150.

21 R. C. L. 1066, Section 107.

Kramer v. Morgan, 85 F. (2d) 96 (C.C.A. 2).

Hurd v. United States Fidelity & Guaranty Co., 227 P. (Kan.) 337.

The United States of America is bound by estoppel of a Judgment the same as a private individual.

34 Corpus Juris 1039, Section 1477.

Fendall's Case, 14 Ct. Cl. 247.

The Atlantic Dredging Company v. The United States, 35 Ct. Cl. 463.

Edmunds v. United States, 24 F. Supp. 742.

Wortham v. Walker, 128 S. W. (2d) 1138.

United States v. O'Grady, 22 Wall. 641.

It is a rule of universal acceptance that a Judg-

ment is res judicata not only as to matters which were actually determined by the Court, but also as to the rights and issues which might have been presented.

30 *American Jurisprudence* 923, *Section* 179.

The Norco, 1 F. Supp. 932 (D.C., W.D., Washington, N. D.)

Golden v. McGill, 3 Wn. (2d) 708, at 720; 102 P. (2d) 219.

Baltimore Steamship Company v. Phillips, 274 U. S. 316, 47 S. Ct. 600, 71 L. Ed. 1069.

The burden is upon the party against whom a judgment is pleaded to show and prove that it was not upon the merits.

Sweeney v. Waterhouse & Co., 43 Wash. 613, at Page 616, 86 P. 946.

Parol evidence is not admissible to contradict or explain the judgment.

34 *Corpus Juris* 1070, *Section* 1515.

McGuire v. Bryant Lumber, etc. Mill Co., 53 Wash. 425, 102 P. 237.

The bankruptcy court is a court of general jurisdiction, and its judgments, orders and decrees are entitled to the same weight as similar judgments, orders and decrees from other courts of general jurisdiction.

Remington on Bankruptcy, 4th Ed., Volume 5, Page 459, Section 2312.75.

The allowance or disallowance of a claim in a bankruptcy proceeding is in the nature of a final

judgment and constitutes a basis for the plea of res judicata.

8 *C. J. S., Page* 1314, *Section* 444.

Woods v. Rapoport, 128 Wash. 140, 222 P. 220.

In the determination of the legality and priority of Federal tax claims, the bankruptcy act is paramount over other Federal and State statutes, and hence the orders of the bankruptcy court upon tax claims are final and conclusive upon all parties.

In re Anderson, 279 Fed. 525.

In this case an income tax was due from the bankrupt to the United States. The United States filed no proof of claim for the tax, and during the administration of the bankruptcy proceedings the trustee served a notice of motion and petition on the collector of internal revenue, returnable before the referee in bankruptcy, in which petition the trustee prayed for "an order barring and foreclosing the United States from participating in the estate herein, or in the alternative that the United States be directed to file its claim or claims with the referee herein on or before a day certain, in order that the trustee may object thereto and hearings had on said claim in accordance with law."

The United States appeared in answer to this petition and moved to dismiss upon the ground that the court was without jurisdiction. The holding of the case is expressed in the syllabus, as follows:

> "Bankruptcy Act, Sec. 64a (Comp. St., Sec. 9648a), provides that 'the court shall order the trustee to pay all taxes legally due or owing by the bankrupt to the United States, state, county, district, or municipality in advance of payment of dividends *** and in case any question arises as to the amount or legality of any such tax the same shall be heard and determined by the court.' *Held* that, under such provision, the court has jurisdiction to determine the amount and validity of a tax claimed by the United States, and that, inasmuch as a trustee can pay the tax only on an order of the court, he may properly, by notice served on the collector for the district, require the United States to file its claim within a time fixed or otherwise be barred, to the end that settlement of the estate may not be unreasonably delayed."
>
> *In re Universal Rubber Products Co.*, 25 F. (2d) 168.

During the course of the bankruptcy proceeding of the Universal Rubber Products Company the trustee, without authority of the referee, voluntarily paid to the United States $26,590.83, as claimed excise taxes and interest. Subsequent to such payment the trustee filed a petition with the referee in bankruptcy, asking that the tax claim of the United States in excess of the amount already paid by the trustee be disallowed, and that the United States be forever disbarred from asserting any further claim on account of the alleged taxes. Upon this claim an order to show cause was issued and served upon the collector of internal revenue, and upon the failure of the collector to appear, an order

was entered, disallowing the tax claim in excess of the amount already paid, namely, $26,590.83. The collector of internal revenue took no exceptions to this order and made no petition to review the same. Subsequently the trustee in bankruptcy filed a claim with the Commissioner of Internal Revenue for a refund of a portion of the taxes paid, and a show cause order was again issued to the collector of internal revenue, to which the collector filed a motion to dismiss, upon the ground that the court was without jurisdiction. Upon a hearing on the petition and motion to dismiss, and after the referee had overruled the motion to dismiss, the government requested permission to file an amended claim against the estate for the excise taxes which had been compromised with the trustee, prior to the entry of the order of December 1, 1925. In holding that the prior order was binding upon both the trustee and the United States, the Court stated:

> "We are of the opinion that the facts of this case do not justify the granting to the trustee of the relief he now seeks. We believe that the order of December 1, 1925, was a final adjudication of this tax claim, and that it is conclusive, both against the trustee in bankruptcy, who asked that it be entered, and against the collector against whom it was entered, without appeal. While it is true, as provided in section 57K of the Bankruptcy Act, as amended (11 USCA, Sec. 93), that claims which have been allowed may be reconsidered for cause, and reallowed or rejected in whole or in part, according to the equities of the case, we do not find any case here presented which justifies the

opening or setting aside of the order of December 1, 1925. The trustee in bankruptcy does not ask to have this order rescinded, nor does he show that he was in any way misled into seeking the same. He ought not, therefore, to be permitted again, nearly a year after the making of that order, to go into the computation of these taxes. There ought to be a time in the course of legal proceedings when the orders of court become final, and when the litigation in a particular matter is ended. It seems to the court that that particular time arrived in this case, when the order of December 1, 1925, was entered. While it may be true that this bankrupt estate ought not to pay excise tax on business transacted between the date of the filing of the petition and the time of adjudication, we believe it is too late now to raise that question; and we pass no opinion upon it.

"We further hold that the petition of the government, presented to the referee in June, 1927, for leave to file amended claims in this case, was presented at too late a date, because of the fact that the claim of the government was finally adjudicated by the order of December 1, 1925. On the whole case, we are of the opinion that no affirmative relief should be granted either to the trustee in bankruptcy or to the government."

In *In re Anderson,* 275 Fed. 397, it was held that the court in bankruptcy had authority to determine the tax claims of the United States, even though the United States did not appear in the proceeding or file a proof of claim. The decision by Judge Learned Hand is as follows:

"Under the present act it has, however, been several times held that the bankruptcy court had jurisdiction directly to reassess or liquidate a tax, regardless of its conclusiveness under

the domestic law or of the procedure established to review it. New Jersey v. Anderson, 203 U. S. 483, 493, 494, 27 Sup., Ct. 137, 51 L. Ed. 284; In re W. P. Williams Oil Corp. (D. C.), 265 Fed. 401; In re United Five and Ten Cent Stores (D. C.), 242 Fed. 1005. In all of these cases the point came up upon claim filed by the taxing power, and therefore this question of jurisdiction did not arise; still the power of the bankruptcy court over the subject-matter is settled.

"The case turns upon the implications necessarily to be drawn from section 64a of the present act (Comp. St., Sec. 9648). It provides:

" 'The court shall order the trustee to pay all taxes legally due and owing by the bankrupt to the United States, state, county, district, or municipality in advance of the payment of dividends to creditors, and upon filing the receipts of the proper public officers for such payment he shall be credited with the amount thereof, and in case any question arises as to the amount or legality of any such tax the same shall be heard and determined by the court.'

"The section shows that taxes are treated as quite different from dividends, as payments to be made before the distribution proper of the estate takes place. Lewis v. United States, supra, may still be law, and certainly no claim for taxes need be filed, but that has nothing to do with the question at bar. The section contemplates that the taxes shall be liquidated and paid at once, a purpose which cannot be accomplished if the estate must wait some action by the taxing power. If the court has no power conclusively to decide the issues, it is obliged to hold up the administration until such time as the United States or a state may choose to proceed. It appears to me to be a necessary implication of the statute that some action may be taken in invitum."

In re Standard Composition Co., 23 F. Supp., 391.

> "*** In the determination of the legality and priority of federal tax claims, the Bankruptcy Act is paramount over other federal and state statutes. Guarantee Title & Trust Co. v. Title Guaranty & Surety Co., 224 U. S. 152, 32 S. Ct. 457, 56 L. Ed. 706; Missouri v. Ross, 299 U. S. 72, 57 S. Ct. 60, 81 L. Ed. 46. ***"

Bearing in mind the principles of law as announced in the foregoing cited cases, the basis for the Judgment of the trial court upon the defense of res judicata may be thus summarized.

The relationship between The Coast Wineries, Inc., and appellee was that of principal and surety. Any defense to the appellant's claim which would have been available to The Coast Wineries, Inc., as principal, was also available to appellee as surety. The Judgments of the Bankruptcy Court of December 21, 1936 and of November 12, 1937, both upon the record and prima facie, were upon the merits of appellant's claim and cannot be impeached or contradicted by oral evidence. The disallowance of such claim in the bankruptcy proceeding was a final judgment and, since in the determination of the legality and priority of Federal tax claims the Bankruptcy Act is paramount over other Federal and State statutes, the orders of the Bankruptcy Court were final and conclusive and constituted a proper basis for a plea or res judicata. The United States of America is bound by the estoppel of judgment the same as a private individual, and hence was and is bound in this case.

In a final attempt to escape the conclusiveness of the defense of res judicata, appellant has attempted to contend that this was and is an action upon the bonds of which appellee was surety, rather than for taxes due. In support of this position appellant relies upon the following cases:

Bowers, etc. v. American Surety Company, 30 F. (2d) 244.

U. S. v. Barth Co., 279 U. S. 370, 49 S. Ct. 366, 73 L. Ed. 743.

Gulf States Steel Co. v. United States, 287 U. S. 32, 53 S. Ct. 69, 77 L. Ed. 150.

Gray Motor Co. v. U. S., 16 F. (2d) 367.

U. S. v. Wyoming Central Association, 70 F. (2d) 869.

Each of these cases is clearly distinguishable from the case at bar.

In each of the cases referred to and relied upon by appellant the bond was one given by a taxpayer to *stay* the collection of an *income tax* already assessed, pending decision upon a claim for abatement. It is the uniform holding of the Federal Courts that this type of bond, being supported by a consideration independent of the tax itself, namely, the stay of enforcement of collection, is a primary and independent obligation on the part of the bonding company, and as such is not subject to defenses which might be asserted by the taxpayer with respect to the tax. The basis for the holdings in these cases is pointed out in *United States v. Wyoming*

Central Ass'n., 70 F. (2d) 869, at Page 872, as follows:

> "The bond, which was based on a valid consideration, gave the United States a cause of action separate and distinct from an action to collect taxes. United States v. John Barth Co., 279 U. S. 371, 49 S. Ct., 366, 73 L. Ed. 743; Bryant-Link Co. v. Hopkins (C. C. A. 5), 47 F. (2d) 1068; United States v. E. Hogshire, Son & Co. (D. C. Va.), 37 F. (2d) 720. In effect, the bond was a contract liability substituted for the tax liability, and was valid and enforceable."

The distinction between the cases relied upon by the appellant and the case at bar was pointed out in *United States v. Springer & Lotz, et al,* 69 F. (2d) 819 (C. C. A. 2), in the following language:

> "*** There is also a class of cases in which a taxpayer or other obligor to the government secures an extension of execution in consideration of a bond to secure the liability. When he has later asserted as a defence that the statute has tolled action upon the principal liability and with it action on the bond, he has always been unsuccessful. United States v. John Barth Co., 279 U. S. 370, 49 S. Ct. 366, 73 L. Ed. 743; Gray Motor Co. v. U. S., 16 F. (2d), 367 (C. C. A. 5); Roberts Sash & Door Co. v. U. S., 38 F. (2d) 716 (Ct. Cl.); Hughson v. U. S., 59 F. (2d) 17 (C. C. A. 9). In such cases the condition cannot mean that the obligor shall be released if action on the principal debt is tolled, for that would defeat the obvious purpose of the transaction. The obligor wishes to hold off execution and gives the bond for that reason; the obligee will normally understand that his delay of execution will not destroy the liability; that on the contrary it is not intended to defeat it but

> merely to extend it. Any other construction would deny the presupposition of the parties that the bond is to preserve the liability. Nothing of the sort is true in the case at bar; no penalty, no tax had arisen; perhaps none ever would; but if it did, the bond was to make certain that it should be discharged. It was only ancillary to the debt, and could not have been intended to survive it. ***"

Appellant has failed to call to the attention of the Court any case where it has been held that a bond, such as the one here at issue, has been held to be an independent and primary obligation of the bonding company.

The Judgment of the trial court, holding the Order of Judge J. Stanley Webster, *In the Matter of the Bankruptcy of The Coast Wineries, Inc.,* to be res judicata as to the appellant's claim against appellee, is amply supported by the record and the Judgment must be affirmed, upon this ground.

Estoppel

There are two factual bases for the conclusion of the trial court that the appellant was an is estopped to prosecute this claim against the appellee, United States Fidelity and Guaranty Company.

The first of these is the agreement between counsel for the Trustee in Bankruptcy of The Coast Wineries, Inc., and counsel for the Internal Revenue Bureau, that in consideration of the withdrawal by the Trustee of his objections to the creditors' claims of appellant for $501.67 and $76.20, respectively

(Defendant's Exhibit A-2 and A-3), the appellant would withdraw its creditor's claim for $9,387.21 (Defendant's Exhibit A-1), which included the taxes, the recovery of which are sought in this action. The trial court specifically found that this agreement was made in fact, and the record is clear and positive that this agreement was reported to the Special Master in the bankruptcy proceeding and acted upon by both counsel and the court. (R. 64, 65) These Findings of Fact are conclusive upon appeal in the absence of obvious errors of law or serious mistakes of fact.

Gila Water Company v. International Finance Corporation (C. C. A.), 13 F. (2d) 1, 2.

Easton v. Brant (C. C. A.), 19 F. (2d) 857, 859.

Exchange Nat. Bank of Spokane v. Meikle (C. C. A.), 61 F. (2d) 176.

McCullogh v. Penn Mutual Life Ins. Co. (C. C. A.), 62 F. (2d) 831.

United States v. McGowan (C. C. A.), 62 F. (2d) 955.

Collins v. Finley (C. C. A.), 65 F. (2d) 625.

The second factual basis for estoppel is to be found in the loss by the appellee of its rights to recover from its indemnitors, and in particular J. J. Dolph, through the acts of appellant.

It appears from the record that as soon as appellee was given notice, dated June 6, 1935 (Plaintiff's Exhibit 2), of possible liability upon its bond, it notified the administratrix of the estate of J. J.

Dolph, deceased, of its intent to hold the indemnitors under the bond for any liability which might be assessed against appellee. (Plaintiff's Exhibits 6, 7; R. 125) When it later came to the attention of appellee that the claim of the appellant, *In the Matter of Bankruptcy of The Coast Wineries, Inc.,* for the taxes in question had been withdrawn and abated, the appellee, thinking it had been relieved from any claim under its bond, took no further steps to assert a claim against the estate of J. J. Dolph, deceased, and permitted the time for filing creditors' claims to expire. (R. 126) The record establishes that the estate of J. J. Dolph, deceased, was substantial and would have been sufficient to pay any claim asserted by appellee under its indemnity agreement. (Defendant's Exhibit A-12).

There can be no doubt that either of the sets of facts as stated would be sufficient in a suit between individual litigants to establish estoppel as a matter of law; and, in fact, we do not understand appellant to contend that this is not so. Rather, appellant rests its contention upon two grounds: first, that an attorney for the Government cannot bind the Government by stipulation or agreement in a court proceeding in which he is authorized to appear, even though such agreement may be acted upon by the counsel and the court; and, second, that the United States of America can never be estopped by the acts of its agents.

No authority has been cited in support of the first contention. As bearing upon the question, we call the attention of the Court to the United States Supreme Court case of *United States v. Rizzo,* 297 U. S. 530, 80 L. Ed., 844. In this case the Court avoided a decision upon the precise question under consideration by finding that no agreement had, in fact, been made by the United States attorney, and stated:

> "* * * Since counsel did not agree to waive the tax lien on the proceeds, and since the Court of Appeals made no finding of such a waiver, we need not consider whether a United States Attorney had authority to waive the Government's right. ***"

It is respectfully submitted that unless the courts and counsel can rely and act upon agreements and stipulations made by a United States attorney, as a part of the conduct of a case which the attorney is employed to prosecute, vast confusion will result and the orderly administration of justice in the courts will be seriously impaired. *If the rule, as contended for by the appellant, should be upheld, it will be impossible for any trial court to accept a statement or stipulation by a Government attorney during the progress of the trial, without first requiring that such Government attorney obtain from some person or bureau claimed to have authority by statute a written consent to the statement or stipulation.*

In support of its second position, appellant has

cited a number of cases, on pages 17, 18 and 19 of its brief. Reference to the cases there cited will disclose the Court stating:

> "*** ordinarily the United States cannot be estopped by the acts of its subordinate officials and agents."
>
> *McDonald v. U. S.* 89 F. (2d) 128.
>
> "Usually, the United States cannot be estopped by any acts of her agents."
>
> *U. S. v. Norton,* 77 F. (2d) 731.
>
> "There is no question of estoppel as a consequence of the mistake involved."
>
> *Dubuque & S. C. R. Co. v. Des Moines Val. R. Co.,* 109 U. S. 329, 27 L. Ed. 952.

In the light of these statements it cannot be categorically stated that the United States cannot be estopped by the acts of its agents. That this is true is demonstrated by the following case, which is directly in point upon the facts of the instant case on the principle of estoppel:

United States v. Alexander, 110 U. S. 325.

The action was one to recover against the sureties on a distillery warehouse bond for taxes claimed to have been assessed against the principal. It appears from the opinion that the Commissioner of Internal Revenue entered an order abating the taxes in question, and that notice of such abatement was given to the sureties. Subsequently the order of the Commissioner, abating the taxes, was withdrawn, and the taxes reestablished. Following

receipt of notice of the oroginal abatement of the taxes, and before notice of the withdrawal of the abatement, the sureties had released indemnitors. Under such circumstances, it was held that the United States was estopped to assert a claim against the sureties upon the bond for the taxes. The following, from the opinion of the Court, by Mr. Justice Woods, is applicable:

> "If we yield to the contention of the appellants in this case, we must hold that the Secretary of the Treasury may, at his discretion and at any time, subject the obligors, both principals and sureties, upon a bond which had once been discharged, to a new liability, by an order of which they had no notice. *It may be fairly presumed that sureties take indemnity from their principals. We cannot hold that after they have had notice of the discharge of the bond on which they were sureties, and when their relations to their principals may have entirely changed, and their indemnity been surrendered, it is within the power of the Secretary of the Treasury, without notice to them, to revive the bond and reimpose its obligation upon them.* We do not think that the statute which authorizes the abatement of taxes and the cancellation of the bond gives authority to the Secretary of the Treasury to retry the question of abatement so as to keep alive the liability of the obligors upon the bond after the taxes have once been abated and they have received notice thereof." (Italics ours.)

The application of the rule was recognized, but refused, upon the facts in *Moses v. United States,* 166 U. S. 571. The following language from the case shows the recognition of the principle:

"* * * And there is no evidence that the sureties suffered any damage by reason of any action or lack of action on the part of the government.

"As to the certificates of non-indebtedness, there is no legal presumption that the sureties had any knowledge that these certificates had ever been given to Howgate either at the time of or soon after his resignation, or at all. The case of *United States v. Alexander,* 110 U. S. 325, does not hold that there is any such presumption. In that case the Secretary of the Treasury having abated taxes against the defendant, under an act of Congress, the Commissioner of Internal Revenue gave notice of the fact to the principals in the bond, who then gave the same notice to their sureties, and the case was not decided on the ground of any presumption of knowledge on the part of the sureties as to the abatement.

"We have looked at the cases cited by the counsel for the defendants upon this branch of the case. They all show either the giving of notice to the sureties of payment of the debt for which they were originally liable, or an admission of payment of the debt by the holder thereof, or a declaration of the holder of the security that he would exonerate the surety, or else a reliance by the sureties upon some conduct of the holder of the security towards them, and a necessary injury to them if the holder should be permitted to subsequently assume a different attitude. The cases referred to are placed in the margin.

"The case here is entirely barren of evidence that the sureties had knowledge of any fact

> going towards their exoneration, or that they acted or failed to act in any particular with reference to their principal by reason of the conduct of the government officials or the existence of the certificates mentioned. We are of opinion also that no such exonerating fact existed."

It clearly appears from this last quoted opinion that had it appeared, as it does in the instant case, that the surety had acquired definite knowledge of the abatement of the tax, and in reliance thereon had released its indemnitors, the doctrine of estoppel, as established in the case of *United States v. Alexander,* 110 U. S. 325, heretofore quoted, would have been held applicable.

Upon both the facts and the law the decision of the trial court, holding the appellant estopped to assert its claim against appellee, United States Fidelity and Guaranty Company, must be affirmed.

CONCLUSION

As to the Finding and Conclusion by the trial court upon the defense of res judicata, we cannot better summarize the position of appellee than to quote from the memorandum opinion of Judge Jeremiah Neterer, which stated: (R. 55-56).

> " 'The order * * * was a final order binding as between the parties. There can be no question but that the jurisdiction of the bankruptcy court was properly exercised * * *.' So said the

> Supreme court in Sampsell v. Imperial Paper & Col. Corporation in opinion filed April 28, 1941.* (not reported). Comenting on a like order the Court further said 'There was no appeal from the order entered * * *. It therefore could not be collaterally attacked * * *.' A like status as here, the Supreme Court added 'The power of the bankruptcy court * * * is complete.'
>
> "This expression from the Supreme Court fixed the status of Judge Webster's order.
> "The conclusion is inevitable that the issue is res adjudicata. The fact and right was directly in issue, and specifically determined by Judge Webster, who had jurisdiction of the subject matter, and of the parties, and the issue may not again be disputed in this case by the parties or their privies. The question of res adjudicata was exhaustively discussed by the writer sitting in the Circuit Court of Appeals with Judge Gilbert and Judge Rudkin in U. S. v. Sakharam Ganesh Pandit, 15 Fed. (2d) 285. The opinion was unanimous. Certiorari was denied by the Supreme Court, 273 U. S. 759. What is said in the 'Pandit' case is applicable and decisive here."

Upon the Finding and Conclusion of estoppel, the trial court merely remarked in its memorandum opinion: (R. 58)

> "Without discussing the question of estoppel, I will say, that I think, upon the record the plaintiff likewise is estopped from asserting its claim in suit."

---

*Sampsell v. Imperial Paper & Col. Corporation, 313 U. S. 215, 61 S. Ct. 904, 85 L. Ed. 1293.

This conclusion was and is amply supported by the record and by legal precedent as heretofore set forth, and constitutes an additional ground why the judgment of the lower court must be affirmed.

Respectfully submitted,

ALLEN, HILEN, FROUDE & DeGARMO,
Gerald DeGarmo,
1308 Northern Life Tower,
Seattle, Washington.

HUBBERT & MULLINS,
W. A. Hubbert,
402 Miller Building,
Yakima, Washington.

H. W. B. SMITH,
444 California Street,
San Francisco, California.

Attorneys for Appellee,
United States Fidelity and Guaranty Company.